STATE TEACHERS' RETIREMENT SYSTEM

ANNUAL REPORT ON

THE PURCHASING POWER

OF ALLOWANCES

APRIL 1, 1998

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EXHIBITS

STATE TEACHERS' RETIREMENT SYSTEM

1998 REPORT TO THE GOVERNOR AND LEGISLATURE REQUIRED BY EDUCATION CODE SECTION 24400

I. LEGISLATIVE REQUIREMENT

Chapter 802, Statutes of 1979 (AB-604), added Education Code Section 24700, renumbered in 1993 as 24400, which reads:

> "The Legislature recognizes that inflation erodes the purchasing power of benefits paid under the State Teachers' Retirement System. It is the intent of the Legislature to understand the degree of erosion of these benefits. The board shall report to the Governor and Legislature no later than April 1 of each year on the extent to which inflation has eroded the purchasing power of benefits under the State Teachers' Retirement System. The board shall indicate the amount of supplementary increases in retirement allowances required to preserve the purchasing power of benefits provided by the system. The board shall also determine and report on the increases."

The legislation has been interpreted as requiring the Teachers' Retirement Board to prepare a report annually, as of the end of the calendar year, to include:

A. The current purchasing power of the allowances payable by the State Teachers' Retirement System (STRS).

B. A summary of allowance increases granted to date.

C. The amount of supplementary increases needed to restore current allowances to 100% of the purchasing power of the initial allowances.

D. The amount of supplementary increases needed to restore current allowances to a minimum of 75% of the purchasing power of the initial allowances.

II. BASE YEAR AND REPORTING PERIOD

The current STRS retirement formula was implemented in 1956 and all existing allowances were adjusted to reflect the improved formula. As of December 1997, only 147 benefit recipients have benefit effective dates prior to 1956.

Therefore, 1956 was selected as the base year for this report and all allowances with benefit effective dates prior to 1956 have been combined in a single group.

STRS has maintained benefit statistics and applied ad hoc allowance increases on a July 1 through June 30 fiscal year basis to coincide with the school year. For this report, however, the calendar year was selected for two reasons:

A. The calendar year is more logical for measuring changes in purchasing power of allowances because the majority of STRS retirees have benefit effective dates in June and July. The base California Consumer Price Index as of June in the year of retirement would effectively be the index as of the benefit effective date for most new retirees.

B. This report is due to the Governor and the Legislature on April 1 each year. The California Consumer Price Index for the preceding December is the most current data available for preparation of this report.

III. HISTORY OF ALLOWANCE INCREASES

The first ad hoc increase was applied to allowances payable as of July 1, 1967. The term "ad hoc increase" refers to a permanent increase in the allowance that is calculated once and paid as long as the allowance is payable. The design of ad hoc allowance increases has varied. Specified percentage increases in the first $300 of allowance were applied as of July 1 of 1967, 1972, 1976 and 1978.

The minimum unmodified allowance was increased as of July 1, 1972; October 1, 1980; and September 1, 1981. This "minimum guarantee" is the least amount of monthly allowance payable for each year of service credit earned by the member. In 1980, the minimum guarantee was increased to $16 per month for each year of service credit; and, in 1981, to $18 per month for each year of service credit.

The first allowance purchasing power increase was applied as of January 1, 1980. The STRS allowance "purchasing power" is measured by changes in the California Consumer Price Index (CCPI), which reflects changes in the cost-of-living since the benefit became effective. The purchasing power maintenance concept attempts to maintain the allowance at a specified percentage of the purchasing power of the initial allowance.

In addition to ad hoc allowance increases which permanently increase the allowance, annual supplemental benefit payments (payable in quarterly installments) have been implemented. The supplemental benefit payments for any one year are dependent upon the money available for that year. Beginning July 1, 1983, an appropriation equal to 5% of the average increase in the statewide payroll for certificated school employees over the previous three years was included in the Governor's Budget for the Retirees' Purchasing Power Protection Account. The proceeds of the account were distributed in supplemental payments to bring those allowances with the lowest purchasing power to a common minimum purchasing power level. As of July 1, 1990, this appropriation has been replaced by a General Fund contribution to the Supplemental Benefit Maintenance Account.

Since July 1, 1984, revenue derived from the use of School Lands has been provided to STRS each year for quarterly supplemental benefit payments. The income derived from School Lands must be prorated among all benefit recipients whose allowances, after application of the annual 2% benefit improvement, are below 75% of the purchasing power of their initial allowances.

Beginning July 1, 1990, and each July 1 thereafter, an amount equal to a specified percentage of total member salaries is transferred from the General Fund to the Supplemental Benefit Maintenance Account (SBMA) in the Teachers' Retirement Fund. The proceeds of the SBMA are distributed annually in quarterly supplemental benefit payments to restore the purchasing power of all allowances to a minimum of 68.2% of the purchasing power of the initial allowance. The amount of payment is determined by the level of allowance purchasing power after any supplemental payment from School Lands funds. Like other supplemental payments, these payments are not vested and will only be made to the extent funds are available in the account.

Effective January 1, 1998, Chapter 939, Statutes 1997 (SB1026) revised the supplemental benefit payment from a minimum of 68.2% to a minimum of 75% of the purchasing power of the initial allowance. The initial quarterly payment to reflect this increase will be provided as of April 1, 1998. Partial funding for this increase will be provided as a result of the Federal sale of the Elk Hills Naval Petroleum Reserve and the payment of 9% of the proceeds of that sale. This Federal payment represents the school lands portion of this sale and Federal payments for the proceeds of this sale will be received by STRS over a period of seven years. Chapter 939, Statutes 1997 also provides the STRS Board the ability to transfer funds from the Teachers' Retirement Fund, increase employer contributions, reduce the distribution below 75%, or to terminate distributions, depending on availability of funds and the provisions of the statute. Like other supplemental payments, these payments are not vested.

IV. CUMULATIVE CHANGES IN CCPI

The percentage changes in the CCPI are measured from June of the calendar year in which the benefit became effective through the most recent December. Exhibit A displays the CCPI figures for June of every calendar year since 1956 and the percent of increase in the CCPI that has occurred from each year through December 1997.

V. CURRENT ALLOWANCE PURCHASING POWER

The average purchasing power level of allowances currently payable to STRS benefit recipients is displayed in Exhibit B by each calendar year in which the benefits became effective. The average percentage increase needed to restore the allowances to 100% of the purchasing power of the initial allowance, based on the December 1997 CCPI, is displayed in the far right column opposite each calendar year.

The information presented in Exhibit B reflects the effects of past inflation. If inflation progresses at a rate greater than the level of benefit maintenance provided by the 2% simple improvement factor, allowance increases may be needed in future years to maintain purchasing power. The cost of maintaining purchasing power will depend on the extent of future inflation.

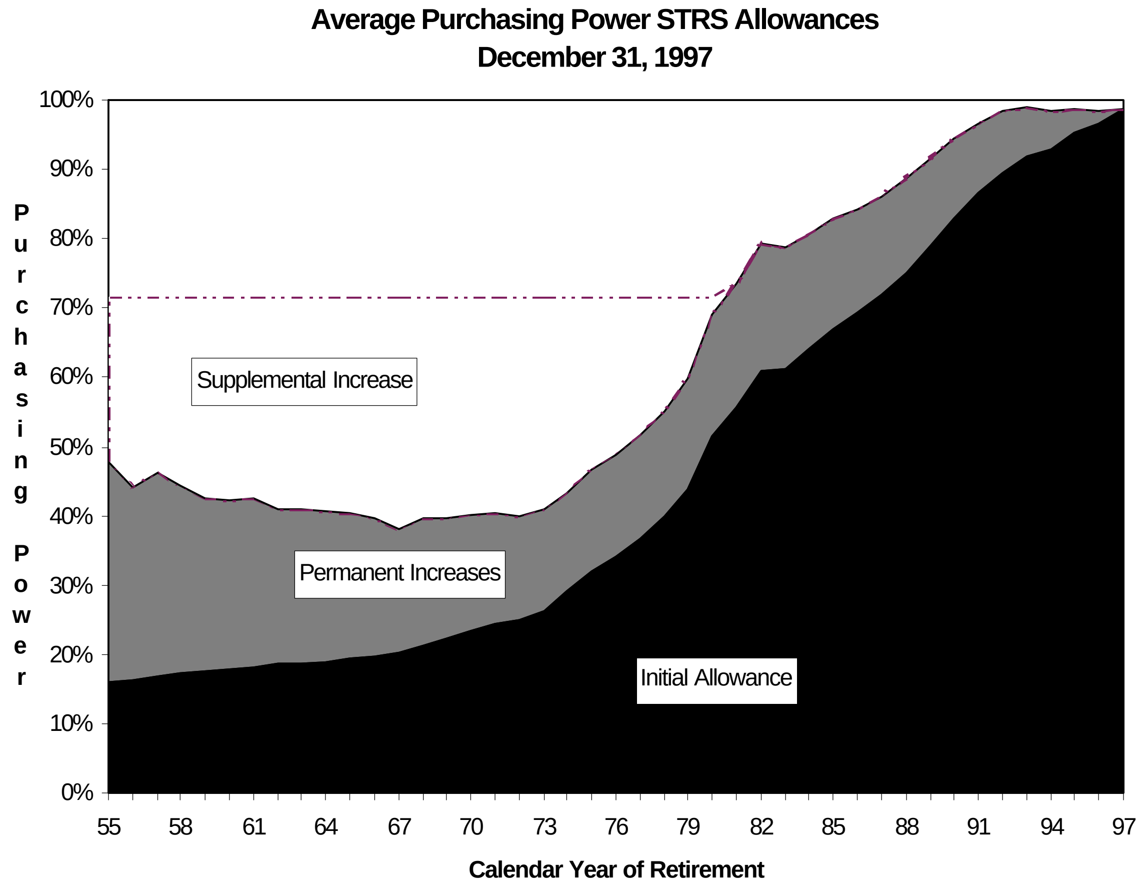
VI. EROSION OF ALLOWANCE PURCHASING POWER

The current STRS retirement plan was implemented in July of 1972. As part of the basic benefits under this plan, STRS allowances are increased by an annual benefit improvement factor equal to 2% of the initial allowance payable to the benefit recipient. Based on the low rates of inflation during the preceding fifteen years, a 2% simple increase was expected to prevent significant erosion of the purchasing power of STRS allowances. However, the rate of inflation increased significantly in the mid-1970's and through most of the 1980's. The CCPI rose 300.0% in the period from June 1972 to December 1997.

Legislation requiring this report was enacted in 1979. The CCPI has risen 128.2% in the period from June 1979 to December 1997. During this period, 19 annual 2% simple benefit improvements have been applied to allowances.

On January 1, 1980, STRS benefit recipients received a substantial ad hoc increase intended to adjust allowances up to 72% of the purchasing power of the initial allowance based on an estimated September 1979 CCPI. The increase effectively raised the purchasing power of STRS allowances to an average 71% of the initial allowances based on the June 1979 CCPI.

Exhibit C displays the number of benefit recipients by percentage of allowance purchasing power level. It is expected (see Exhibit D) that allowances payable to 45,735 (29.6%) benefit recipients will be below 75% of the purchasing power of their initial allowances in June 1998, while 108,674 (70.3%) are expected to be at or above the targeted 75% purchasing power maintenance level.



The darkest area of this graph shows the current average purchasing power of the initial STRS allowances using the change in the California Consumer Price Index from June of the calendar year in which the benefits became effective to December of 1997. The gray area shows how the permanent allowance increases, the annual 2% benefit improvement plus any applicable ad hoc increases, have added to the purchasing power of the initial allowances. During the 1997/98 year, the purchasing power of the allowances have been raised to the level of the dashed line by means of quarterly supplemental benefit payments. These quarterly payments are payable on an annual basis subject to revenues available from School Lands and General Fund contributions to the Supplemental Benefit Maintenance Account.

VII. COST OF RESTORING ALLOWANCE PURCHASING POWER

The estimated cost of supplemental benefit payments to restore the allowances payable in 1998/99 to various levels of purchasing power is shown in Exhibit D. The State Lands Commission estimates that there will be $4,146,000 in revenues for supplemental benefit payments to STRS benefit recipients in the 1998/99 year. These payments will be prorated among those benefit recipients whose allowances, after application of the annual 2% benefit improvement, have fallen below 75% of the purchasing power of their initial allowances.

An additional $214,885,807 will be required to bring the purchasing power level of all allowances to a minimum of 75% of the initial allowance. In accordance with the provisions of Education Code section 22954, this amount may be provided through a July 1 transfer of General Fund contributions to the SBMA equal to 2.5% of the prior year salaries on which STRS member contributions are based.

A history of supplemental benefit payments and the sources of income for those payments is displayed in Exhibit E. This exhibit shows that prior to 1992/93 the Teachers' Retirement Fund provided the balance of the amount needed in the SBMA to restore purchasing power to a minimum of 68.2% of the purchasing power of the initial allowance. General Fund contributions made in subsequent years which were in excess of that needed to restore purchasing power to a minimum of 68.2%, were used to repay the Teachers' Retirement Fund. With full repayment to the Teachers’ Retirement Fund, excess General Fund contributions are now used to establish and maintain a three year reserve in the SBMA. This three year reserve will assist with funding subsequent supplemental benefit payments.

EXHIBIT A

STATE TEACHERS' RETIREMENT SYSTEM

INCREASE IN CALIFORNIA CONSUMER PRICE INDEX FROM YEAR OF

BENEFIT EFFECTIVE DATE THROUGH DECEMBER 1997

Calendar Year of Benefit Effective Date	CA Consumer Price Index as of June	Percent Increase through December 1997
1956	26.2	518.3
1957	27.1	497.8
1958	28.1	476.5
1959	28.5	468.4
1960	29.1	456.7
1961	29.5	449.2
1962	30.0	440.0
1963	30.2	436.4
1964	30.8	426.0
1965	31.6	412.7
1966	32.1	404.7
1967	32.9	392.4
1968	34.3	372.3
1969	36.0	350.0
1970	37.9	327.4
1971	39.4	311.2
1972	40.5	300.0
1973	42.7	279.4
1974	47.1	243.9
1975	52.0	211.5
1976	55.2	193.5
1977	59.5	172.3
1978	64.6	150.8
1979	71.0	128.2
1980	83.3	94.5
1981	90.1	79.8
1982	98.5	64.5
1983	99.1	63.5
1984	103.6	56.4
1985	108.4	49.4
1986	112.2	44.4
1987	116.3	39.3
1988	121.7	33.1
1989	128.2	26.4
1990	134.3	20.6
1991	140.1	15.6
1992	145.2	11.6
1993	148.9	8.8
1994	150.7	7.5
1995	154.2	5.1
1996	156.6	3.4
1997	160.0	1.3

The percent increase from calendar year of the benefit effective date was calculated by dividing the December 1997 CCPI (162.0) by the index figure for the year of retirement and adjusting the results to reflect the percentage increase. For example, the calculation for 1956 is : 162.0 / 26.2 = 6.183 - 1.000 = 5.183 x 100 =518.3

EXHIBIT B

STATE TEACHERS' RETIREMENT SYSTEM

AVERAGE ALLOWANCE PURCHASING POWER AS OF DECEMBER 1997

Calendar Year of Benefit Effective Date (1)	CCPI Increases through December 1997 (2)	Average Allowance Increases through December 1997 (3)	Average Purchasing Power December 1997 Allowance (4)	Average Increases Needed to Restore Full Purchasing Power (5)
Prior to 1956	530.4%	202.9%	47.8%	108.1%
1956	518.3%	172.4%	44.1%	127.0%
1957	497.8%	176.0%	46.2%	116.6%
1958	476.5%	155.4%	44.3%	125.7%
1959	468.4%	142.3%	42.6%	134.6%
1960	456.7%	135.3%	42.3%	136.6%
1961	449.2%	133.5%	42.5%	135.2%
1962	440.0%	120.8%	40.9%	144.6%
1963	436.4%	119.8%	41.0%	144.0%
1964	426.0%	114.9%	40.8%	144.8%
1965	412.7%	106.8%	40.3%	147.9%
1966	404.7%	100.0%	39.6%	152.4%
1967	392.4%	87.8%	38.1%	162.2%
1968	372.3%	87.2%	39.6%	152.3%
1969	350.0%	78.8%	39.7%	151.7%
1970	327.4%	71.6%	40.1%	149.1%
1971	311.2%	66.4%	40.5%	147.1%
1972	300.0%	59.4%	39.8%	150.9%
1973	279.4%	55.8%	41.0%	143.5%
1974	243.9%	48.5%	43.2%	131.6%
1975	211.5%	45.2%	46.6%	114.5%
1976	193.5%	43.0%	48.7%	105.2%
1977	172.3%	40.7%	51.7%	93.5%
1978	150.8%	38.6%	55.2%	81.0%
1979	128.2%	36.5%	59.8%	67.2%
1980	94.5%	34.4%	69.1%	44.7%
1981	79.8%	32.1%	73.4%	36.1%
1982	64.5%	30.4%	79.3%	26.2%
1983	63.5%	28.9%	78.8%	26.8%
1984	56.4%	26.0%	80.6%	24.1%
1985	49.4%	24.0%	83.0%	20.5%
1986	44.4%	21.8%	84.3%	18.6%
1987	39.3%	19.9%	86.1%	16.2%
1988	33.1%	17.9%	88.6%	12.9%
1989	26.4%	15.9%	91.7%	9.1%
1990	20.6%	13.9%	94.4%	5.9%
1991	15.6%	11.8%	96.7%	3.4%
1992	11.6%	9.8%	98.4%	1.6%
1993	8.8%	7.8%	99.0%	0.9%
1994	7.5%	5.9%	98.5%	1.5%
1995	5.1%	3.9%	98.8%	1.2%
1996	3.4%	1.9%	98.5%	1.5%
1997	1.3%	0.0%	98.7%	1.3%

Explanation of source and/or calculation of data in columns 3, 4 and 5:

Column 3 - Increases from all sources as a percentage of initial allowance. Obtained by dividing total current allowance by total initial allowance and adjusting to a percentage.

Column 4 - Purchasing Power as of December 1997. Obtained by dividing total current allowance payable by full CCPI adjusted allowance. Based on totals for all benefit types by calendar year effective date.

Column 5 - Percentage increase in current allowance payable required to restore full 100% purchasing power as of December 1997. Obtained by dividing the fully adjusted CCPI allowance factor (column 2) by the percentage increase to date (column 3) and adjusting to a percentage. Example: (530.4 + 100) / (202.9 + 100) =2.081 x 100 =208.1 - 100 = 108.1%

EXHIBIT C

STATE TEACHERS' RETIREMENT SYSTEM

ESTIMATED NUMBER OF BENEFIT RECIPIENTS

BY PURCHASING POWER LEVEL

AS OF JUNE 30, 1998

Purchasing Power Level	Benefit Recipients Number	Benefit Recipients Percent
95.1% - 100.0%	52,906	34.3%
90.1% - 95.0%	13,810	8.9%
85.1% - 90.0%	7,334	4.8%
80.1% - 85.0%	18,175	11.8%
75.1% - 80.0%	16,449	10.7%
70.1% - 75.0%	5,167	3.3%
65.1% - 70.0%	4,687	3.0%
60.1% - 65.0%	828	.5%
55.1% - 60.0%	4,835	3.1%
50.1% - 55.0%	7,638	4.9%
45.1% - 50.0%	6,970	4.5%
40.1% - 45.0%	5,772	3.8%
0.0% - 40.0%	9,924	6.4%
	154,495	100.00

The benefit recipients are grouped by percentage of allowance purchasing power level. Those whose initial allowances plus permanent increases from all sources are below 40% of full purchasing power are combined in one group.

EXHIBIT D

STATE TEACHERS' RETIREMENT SYSTEM

ESTIMATED COST OF RESTORING

ALLOWANCE PURCHASING POWER

THROUGH SUPPLEMENTAL BENEFIT PAYMENTS

DURING FISCAL YEAR 1998/99

Restoration Level	Benefit Recipients	Total Amount Required	Amount from School Lands	Additional Amount Required
68.2%	36,502	$161,150,312	$4,146,000	$157,004,312
75.0%	45,735	$219,031,807	$4,146,000	$214,885,807
100.0%	153,867	$640,668,344	$4,146,000	$636,522,344

STATE TEACHERS' RETIREMENT SYSTEM

RESTORATION OF ALLOWANCE PURCHASING POWER

THROUGH SUPPLEMENTAL BENEFIT PAYMENTS

Retirees' Purchasing Power Protection Account

				Income Source		
Year	Purchasing Power	Count	Total $ Required	School Lands	Investment Earnings	Budget Appropriation
83-84	58.4%	35,654	$ 21,394,183	$ n/a	$ 894,183	$ 20,500,000
84-85	62.4%	57,189	54,306,976	10,119,124	2,426,456	41,761,396
85-86	65.5%	56,811	85,675,243	7,770,757	3,994,458	73,910,028
86-87	68.2%	57,343	122,275,289	4,167,970	5,511,448	112,595,871
87-88	68.2%	59,092	128,231,357	6,083,374	5,317,456	116,830,527
88-89	68.2%	58,037	143,061,285	4,479,266	5,956,019	132,626,000
89-90	68.2%	55,971	158,274,048	2,751,075	n/a	155,522,973*

* The 89-90 appropriation was from the Teachers' Retirement Fund. This amount plus regular interest was repaid from General Fund contributions to the Supplemental Benefit Maintenance Account.

Supplemental Benefit Maintenance Account

				Income Source			3 Year
Year	Purchasing Power	Count	Total $ Required	School Lands	Teachers' Retire. Fund	General Fund	Reserve Balance
90-91	68.2%	52,199	$168,922,827	$2,964,211	$111,103,596	$ 54,855,020	$ 0
91-92	68.2%	48,650	178,057,887	2,913,338	56,985,521	118,159,028	0
92-93	68.2%	54,029	184,360,762	6,658,800	0	177,892,642	0
93-94	68.2%	49,113	178,886,980	4,225,808	0	174,661,172	0
94-95	68.2%	46,459	168,359,918	4,973,687	0	163,386,231	0
95-96	68.2%	41,703	168,517,183	1,171,779	0	167,345,404	0
96-97	68.2%	38,939	157,915,696	1,870,825	0	156,044,871	113,307,404
97-98	68.2%**	36,745	70,696,786	1,197,500	0	69,499,286	
	75.0%**	45,780	102,723,900	1,197,500	0	101,526,400	318,573,932

**Percentage changed to 75% effective 1/1/98 payable 4/1/98 (Chapter 939, Statutes 1997)